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INDICATORS AND 3R-TYPE MEASURES IN OVERCOMING FINANCIAL DIFFICULTIES OF COMPANIES

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Abstract: *In the economic life of companies, various financial difficulties can appear, regardless of their object of activity, domain, geographical area, or geopolitical context. The economic reality proved that managing individual difficulties one at a time has little chance of succeeding; because of this, there are international concerns in establishing the regulatory framework and identifying instruments to ensure that the firm can overcome the financial difficulty. Concerns in this sense have been explicitly mentioned for the first time by the World Bank when Principles for effective insolvency and creditor/debtor regime were established in 2001. Recently, the European Parliament has elaborated the EU Directive 2019/1023 regarding the framework of preventive restructuring, debt remittance, and forfeiture of law, besides measures to increase the efficiency of restructuring procedures, insolvency, and debt remittance, which modifies the EU Directive 2017/1132 regarding restructuring and insolvency. While implementing the EU Directive of restructuring in national legislation, the paper analyses and synthesizes the measures of reorganizing and recovering companies while also considering the required legislative instruments. From a practical aspect, the authors' contribution concretizes in a set of economic and financial indicators that warn/reveal the state of financial difficulty of companies. Establishing these indicators represents technical aspects that need to be clarified by the national law and the EU Directive, and it constitutes the challenge of readjusting the companies. The faster the intervention, the bigger the chances of salvaging the company. Interest in this topic is growing, given the temporary suspension of the activities of many companies caused by several factors. In the context of the measures taken to prevent the COVID-19 pandemic and increase the costs of raw materials, gas, and energy, the economic evolution is unpredictable and challenging. Considering that we are in the process of modifying the national legislation, the proposed set of indicators cannot be verified on the level of companies that encounter financial difficulties. Therefore, applying and practically verifying these economic and financial indicators will be the subject of subsequent research.*

Keywords: *financial difficulty, reorganizing, recovery, resilience, economic and financial indicators, framework.*

JEL Classification: G34, G33, G38

1. Introduction

Financial difficulty is a topic of great interest that focuses the attention of companies on finding ways of economic recovery and getting out of an impasse. Companies are interested in more than just financial difficulties. The legislator is also interested in creating the general legal framework and guidance, meeting the companies' needs, and being seen as partners: producers, employers, taxpayers, etc. The accountants are also interested in this area; their purpose is to provide solutions from the 3R perspective (recovery, reorganization, resilience) for the companies that have their financial statements analyzed.
Web of Science offers ample information about the researchers' interest in this study area. By associating our study "financial difficulty" with a keyword such as "reorganization," "resilience," and "economic recovery," we have identified that between 2018 and 2022, the Economics, Business, Business Finance, and Law domains have been published 1.386 scientific papers in Open Acces regimen.
Figure **1** presents the Web of Science categories with the most published scientific papers that studied this keyword combination.

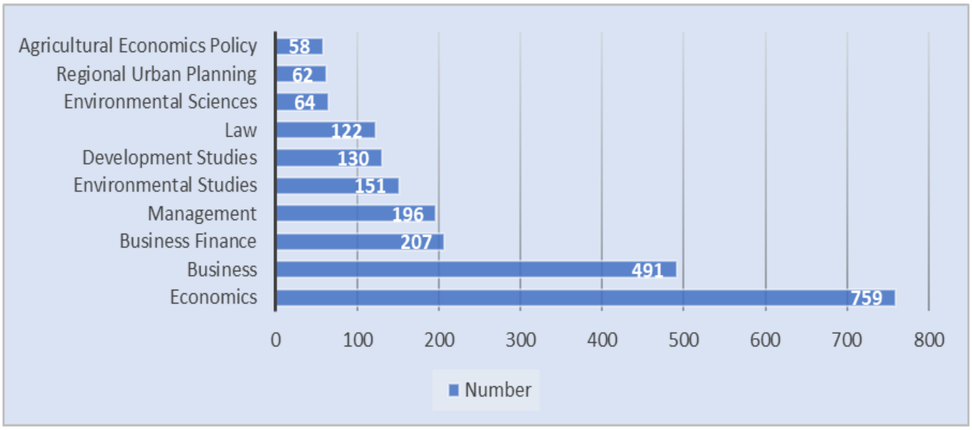

Figure 1: Number of scientific papers on categories on Web of Science
Source: Authors' projection by https://access-clarivate-com.am.e-nformation.ro/ with Microsoft Excel

2. Literature review

It can be noticed that the researchers' interest is focused on domains such as Economics and Business, a priority in the ten areas of study also being Business Finance, Management or Law.
The density of connections between the keywords from the title, abstract, or those mentioned by the authors is extensive; a grouping of elements done with WoSviewer has generated 7 clusters of the 429 items linked to our topic research. We have identified an increased interest in "resilience," a keyword that appears in 5 out of the 7 clusters under different connotations: organizational resilience, supply chain resilience, economic resilience, financial resilience, psychological resilience, regional resilience, community resilience, building resilience, business

resilience, entrepreneurial resilience, organizational resilience, and urban resilience.
Although the spotlight is on resilience, it cannot be studied without a legal framework that regulates this direction. Studying the connection of the word "framework" (**figure 2**), we have ascertained that there are research links to topics such as performance, vulnerability, integration, critical success factors, dynamic capabilities, adaptation, sustainability, and even design.

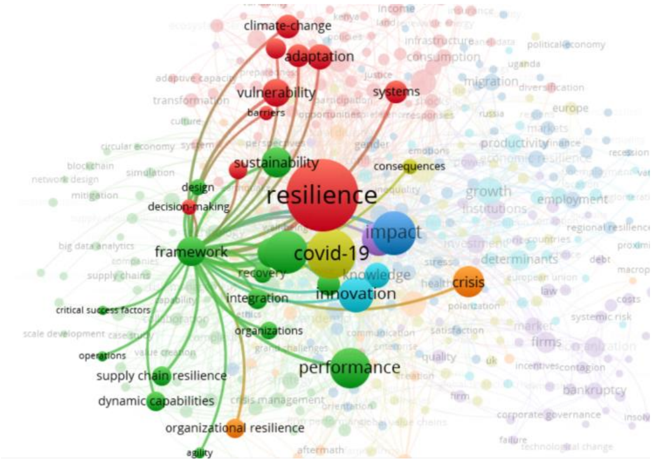

Figure 2: Research connections of the word “framework”
Source: Authors projection by https://access-clarivate-com.am.e-nformation.ro/ with VOSviewer

These links confirm that there is an interest so a framework that would target companies' reintegration pattern (design) as a response to vulnerabilities and organizational resilience.
It can also be noticed the influence of the COVID-19 pandemic on the studies overlooking financial difficulties and their consequences (**figure 2**), as well as their link to "resilience" and "recovery" (**figure 3**).

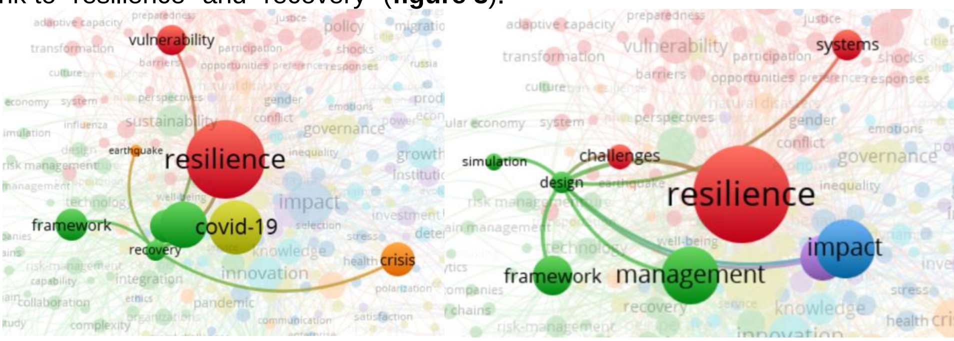

Figure 3: Research links of the words ”recovery” and ”design”
Source: Authors projection by https://access-clarivate-com.am.e-nformation.ro/ with VOSviewer

The state of vulnerability in crisis conditions, such as COVID-19, has shifted the attention of researchers toward recovery and resilience (**figure 3**), with a significant interest in the already existing framework or the one to be elaborated.

The research links of the design to "framework," "simulation," "management," "challenges," and "systems" reveals a strong connection between the purpose of the legal framework on creating systems and opportunities of recovery to the companies in financial difficulty and active management. Through "diligent management," we understand organizing an impactful way of leading that will respond to the crisis challenges that affect their activity, their ability to recover, reorganize, and their resilience.

We can state that a company's objectives are either short-term or long-term. In the category of short-term objectives, we include the growth of the company by orienting it towards the market, expanding the client portfolio and rewarding their loyalty, increasing the rate of satisfaction of its employees, raising the fiscal value and the profit, raising the financial performance and strategic reorganization of the company.

Amongst the long-term objectives, the following are included

- consolidating the financial position by occupying an honorable place in the category of high-performing companies,
- rising the equity and the net asset,
- increasing the ability to face the challenges generated by outside factors,
- innovating and transforming the model of business,
- avoiding financial difficulties and enduring a high-paced competitive market.

The Small and Medium-sized Business sector (SMB) is an integral part of the economic entities and represents a significant force for the economic development of a country; however, this sector is the most prone to being affected by financial risk and financial difficulties. According to Slusarczyk and Grondys 2019, the most frequent manifestation of financial risk for SMBs is the difficulty in financing a business and lack of funds for development.

The financial difficulties, financial risk, and resilience of companies have been the subjects of research for a multitude of studies and many articles of specialty.

Several disruptive factors generate financial difficulties:

- *Risk and financial fragility or incapacity of resilience* (Slusarczyk and Grondys, 2019; Rozmainsky et Rodionova, 2021; Baltes and Pavel, 2019; Huang and Farboudi Jahromi, 2021);
- *Manipulation of accounting information in order to be eligible for bank financing* (Grammatikos and Papanikolaou 2021;
- *Reducing the number of employees, workplace conditions, and employee satisfaction as a factor influencing financial difficulties* (Lopes et al., 2019; Rico et al., 2021); According to Bodnar et al., there is a strong and significant correlation between financial difficulties, credit difficulties, downsizing, and salary. Thus, these difficulties affect employee satisfaction.

Various specialized articles reveal the importance of predicting the financial difficulties of the control systems and management decisions. (Durica et al 2019; Svabova et Michalkova L. 2020, Štefko et al 2020, Zéman and Lentner 2018)

Any management team would try to take measures toward an *economic recovery* when financial adversities occur. Who can get involved to help the economic recovery and the resilience of economic entities? What can be done?
The state should intervene via its economic and fiscal policies or through specific provisional aid measures (federal funds, help aids): Staal, 2020; Yuan et al., 2022; Hepburn et al., 2020,
Sergant and Van Cayseele (2019) say that state aid can influence access to resources, which can prevent financial difficulties. However, they can also be a way of economic recovery for the companies. Economic recovery can also be the efficient use of resources in the activity and workforce occupation. (Acharya et al., 2019)
According to Jaimovici and Siu (2020), there is a link between economic recession and the unemployment rate and economic recovery and increased employment rate.
Innovation is the phenomenon that leads to an increase in resilience on a macro and microeconomic level. For example, in the study by Bristow and Healy (2018), it is said that the areas or communities where the innovation level is higher have proven to be more resilient to financial difficulties or crises, or it has been observed a faster recovery.
In the context of companies' financial difficulties, the problem of their reorganization must be addressed. The success of the reorganization process to save the companies depends on various factors: the quality of the accounting systems, the quality of early warning systems, and the existence of a reorganization plan. (Kuttner et al. 2022)
The owners' commitments and financial contributions, as the business owner's personality, can considerably impact the reorganization process's success. At the same time, the latter's experience is not a factor to be neglected, but it does not significantly influence (Mayr et al., 2021).
The human factor, the legislative factor, and the need for some analysis models of the ability to reorganize significantly impact the process's success. (Stroie si Dușescu 2019; Ippoliti and Tria 2020).

3. Reorganization - the second chance implemented through the insolvency procedure

The rationality of concerns in overcoming the state of difficulty is as simple as it is real: a company that exceeds these general difficulties or the financial ones is a company that will contribute to the economic development of the increased standard of living of its employees. This has appeared as the idea of the second chance implemented via a reorganization as a component of the insolvency procedure.
Insolvency does not mean bankruptcy. Insolvency is defined as "*the state of the debtor's patrimony that characterizes as monetary funds insufficiency on paying the certain, liquid and exigible debt, and that is assumed when the debtor, after 60 days following the payment due date, has not paid its debt to its creditor*" according to Law no. 85/2014. The insolvency procedure starts with a period of observation that allows the company, under the judicial administrator's supervision, to analyze its ability to recover. With the vote, consequently, with the agreement of the

creditors, the reorganization plan will be approved and confirmed afterward by the syndic judge so that the company goes into the reorganization phase.
Only in the case in which no reorganization plan is proposed, or the proposed plan is not approved by the creditors (or is not confirmed by the syndic judge) does the company go into bankruptcy. Nevertheless, of course, except when the company does not have assets, it can file to start the simplified bankruptcy procedure.

Figure 4 presents the report on the number of insolvency procedures in the period between 2010 and the first semester of 2022.

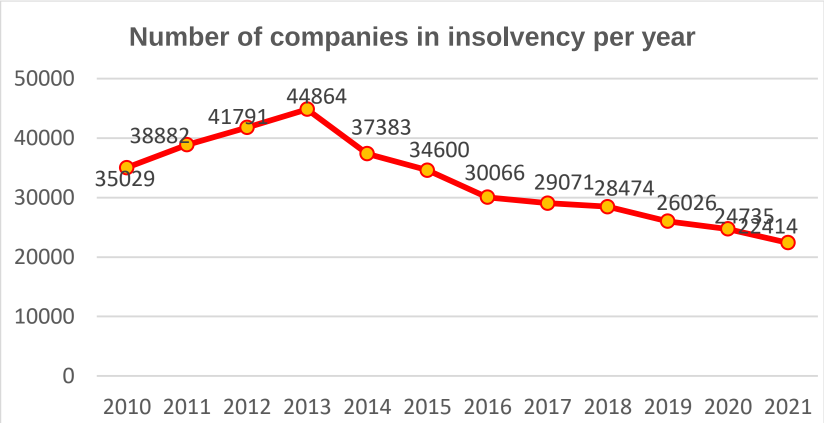

Figure 4: Number of companies in insolvency procedures per year
Source: ONRC – National Office of Commerce Registry

An increased number of companies that go into insolvency can be noticed after the financial crisis of 2008-2009, as apparent effects of it, but not limited to that crisis.

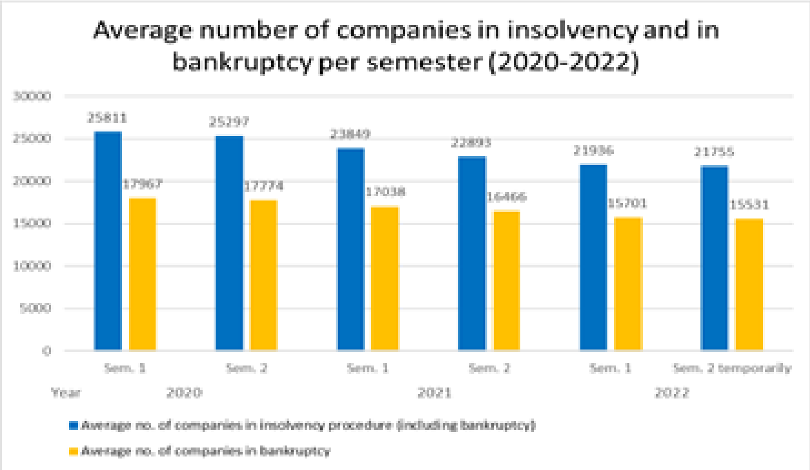

Figure 5: Average number of companies in insolvency proceedings and bankruptcy per semester (2020-2022)
Source: ONRC - National Office of Commerce Registry

In the **figure 5**, we analyze the rapport between the total number of insolvency procedures opened (including bankruptcy) and bankruptcy procedures between 2020-2022.

4. Preventive procedures regarding insolvency

A large number of opened procedures in insolvency is also due to protective legislation for the debtor (Law no. 85/2006 regarding the insolvency procedure), which determined a considerable number of companies to speculate on this legislation's advantages given to the debtor.

Perfecting the legislation in 2014 (Law no. 85/2014 regarding the prevention of insolvency and insolvency procedure), re-establishing the balance between the creditors and the debtor company is a significant cause in the decreased number of insolvency procedures opened after the entry into force of this law.

The decrease in the number of procedures (reorganization and bankruptcy) can easily be noticed, but the ratio of bankruptcy remains high in the overall scheme. Therefore, specific measures are imposed (legal framework) for the early recovery of companies.

For the clarity of the information, we must note that many reorganization plans fail due to the massive impact of triggering the insolvency procedure on economic partners and the creditors' reluctance.

It is also true that declaring insolvency and opening its procedure is considerably delayed; the companies postpone triggering the insolvency procedure beyond the limit, making a recovery possible. In short, the companies declare their insolvency when there is no solution for recovery. The management team's low degree of entrepreneurial education is a severe hindrance to the company's recovery.

The reduced share of the successful reorganization procedures, finalized with the reinsertion of the economic market of the company, has led international (as well as national) authorities to search for solutions in this sense.

The trend is clear: overcoming financial difficulties "on the go" without triggering the insolvency procedure. It becomes clear that resilience, the companies' continuity, and keeping them on the market is the best solution for the companies and the economic environment, with beneficial effects for the national and global economy.

In this context, *the EU DIRECTIVE 2019/1023* is approved by the European Parliament and Council*, on preventive restructuring frameworks, on the discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency, and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).*

Restructuring represents a preliminary step to insolvency when preventive or pre-insolvency procedures are set up to give another chance of recovery to companies facing difficulties.

According to the Directive, "restructuring should enable debtors in financial difficulties to continue the business, in whole or in part, by changing the composition, conditions or structure of their assets and their liabilities or any other part of their capital structure — including by sales of assets or parts of the business or, where so provided under national law, the business as a whole — as well as by carrying out operational changes. Unless otherwise explicitly provided for by national law, operational changes, such as the termination or amendment of contracts or the sale or other disposal of assets, should comply with the general requirements that are provided for under national law for such measures, in particular civil law and labor law rules. Any debt-to-equity swaps should also comply with safeguards provided for by national law. Preventive restructuring frameworks should, above all, enable debtors to restructure effectively at an early stage and avoid insolvency, thus limiting the unnecessary liquidation of viable enterprises. These frameworks should help prevent job losses and the loss of know-how or skills. It should maximize the total value to creditors, owners, and the economy as a whole in the event of liquidating the assets of the enterprise or in the case of the best future. "

The objective of this EU Directive is to perfect the market, free movement of capital, economic action freedom, as well as:

- viable companies and entrepreneurs facing financial adversities should have access to a national framework of effective preventing restructuring procedures that would allow them to continue working;
- insolvency avoidance.

The Directive sets up the preventive procedures (pre-insolvency) to be applied by companies that have financial difficulties but do not exclude applying these procedures to companies facing adversities other than financial ones. Sure enough, general adversities, such as losing an important contract, as the Directive exemplifies, will become financial difficulties and affect the company's ability to pay its debts when due, meaning in the foreseeable future. What we can add to the causes of difficulty for companies are rising costs of raw materials, high prices of elements in general, electric energy costs (current state), and even workforce problems – its significant fluctuation. Moreover, the adversities of a company will reflect in its financial statement and affect its financial indicators. In this regard, we can compare this microeconomic state (of a company) to a macroeconomic one, where economic crises, even if non-financial factors cause them, are also financial crises, affecting the ability to pay on term the government debt.

Thereby, usage of the term "financial difficulty" in the Directive is justified. However, the application area allows EU states to extend over the companies that encounter adversities generated by causes other than financial if this difficulty affects the debtor's ability (present or in the future) to pay its debts on terms.

The Directive regarding restructuring framework does not define the financial difficulty state, leaving this definition up to its member states, according to each one's particular state system and national law.

Implementing the Directive in national law was made via Law no. 216/2022 regarding the alteration and addition to Law no. 85/2014 regarding insolvency preventing procedures and insolvency. The national law, in consensus with the Directive, extends the financial difficulty and defines the state of difficulty (art. 5, line 1, pt. 26, 2): "Difficulty represents the state generated by any circumstance that determines a temporary impairment of activity, which leads to a natural and severe threat on the company's ability in the future to pay its debts on the term if no proper measures are taken; the debtor found in a state of difficulty can pay its debts as they become due."

The difficulty state must not be insolvency, respectively "it does not affect the ability to pay current debts on the term when they are due," and by applying the pre-insolvency measures, the actual insolvency can be avoided.
The pre-insolvency procedures stated in the national legislation are "restructuring agreement" and "preventive concordat," These preventive procedures imply the existence of an early warning indicators system.
Figure 6, below, presents the connection between preventive procedures and insolvency (reorganization/bankruptcy) in saving viable companies that go through a problematic state:

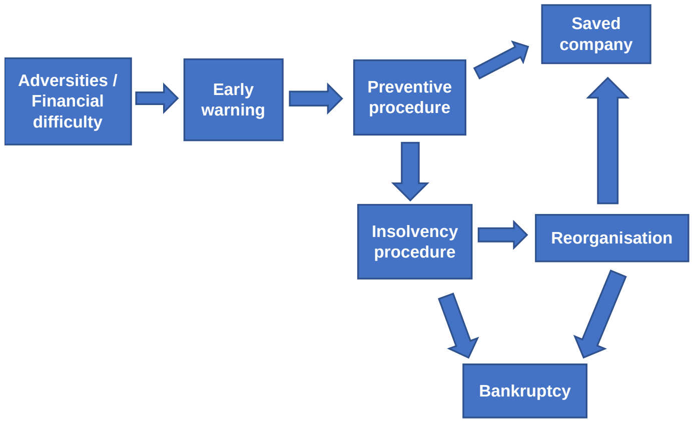

Figure 6: Connection between preventive procedures and insolvency in saving viable companies
Source: Author's projection

5.Conclusions

The main challenge to companies will be identifying the complex state/financial difficulty that will allow access to preventive procedures in insolvency, with the purpose of their recovery. In this context, the early warning system is a topic of great actuality for specialists.
In our opinion, the most valuable indicators in forming the early warning system would have to focus on the three significant categories: solvency, liquidity, and rentability, completed by other indexes for structure.
Studying these indicators that will take part in the early warning system will represent the following research topic for us.

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